

[Assembly Bill 1396](#) (Bonta)

Date: 06/03/15

Program: Cigarette and Tobacco Products Tax

Sponsor: Author

Revenue and Taxation Code Sections 30130.53 and 30130.55

Effective: Immediately upon enactment

Michele Pielsticker (Chief) 916.322.2376

Cindy Wilson (Analyst) 916.445.6036

Joe Fitz (Revenue) 916.445.0840

This analysis only addresses the provisions that impact the Board of Equalization (BOE).

Summary: This bill:

- Requires the Board of Equalization (BOE) to determine the effect that the additional cigarette tax¹ and the resulting indirect tobacco products tax increase on cigarette and tobacco products consumption in this state;
- Requires the BOE to backfill existing cigarette and tobacco product tax funds² to offset revenue decreases that result from the additional cigarette tax; and
- Appropriates Tobacco Law Enforcement Account funds to the BOE, the Department of Justice (DOJ), and the State Department of Public Health (CDPH) to supplement cigarette and tobacco products law enforcement.

Summary of Amendments: Among other things, the amendments since the previous analysis subject funds in the Tobacco Law Enforcement Account to review and appropriation by the Legislature, increase the administrative cost cap from 2% to 5%, and add an urgency clause.

Purpose: To direct tobacco tax revenues toward increasing quality patient care.

Fiscal Impact Summary: \$67 million in fiscal year (FY) 2015-16 and \$135.9 million in FY 2016-17 from the California Tobacco Tax Act of 2015 Fund to backfill existing cigarette and tobacco products funds.

Existing Law: Cigarette and Tobacco Products Tax Law. Existing law imposes an \$0.87 per package of 20 (43 ½ mills per cigarette) cigarette tax. The cigarette tax components and the revenue disposition are as follows:

- \$0.10 per pack (5 mills per cigarette) is allocated to the General Fund (Sections 30101 and 30462 of the Revenue and Taxation Code (RTC));
- \$0.02 per pack (1 mil per cigarette) is allocated to the Breast Cancer Fund (RTC Sections 30101 and 30461.6);
- \$0.25 per pack (12 ½ mills per cigarette) is allocated to the Cigarette and Tobacco Products Surtax Fund (RTC Sections 30122 and 30123); and
- \$0.50 per pack (25 mills per cigarette) is allocated to the CCF Trust Fund (RTC Sections 30131.2 and 30131.3).

RTC Section 30123 imposes a tax upon the distribution of tobacco products, based on the wholesale cost of these products at a tax rate that is equivalent to the combined rate of tax imposed on cigarettes. In addition, Section 30131.2 imposes an additional tobacco products tax at a rate equivalent to the \$0.50 per pack cigarette tax. The BOE determines the tobacco products tax rate annually based on the March 1 wholesale cost of cigarettes. The 2014-15 tobacco products rate is 28.95%.

¹ Imposed pursuant to [Senate Bill \(SB\) 591](#) (Pan).

² California Children and Families (CCF) Trust Fund (Proposition 10), the Cigarette and Tobacco Products Surtax Fund (Proposition 99), the Breast Cancer Fund, and the General Fund.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

The BOE deposits the tobacco products surtax imposed under Section 30123 into the Cigarette and Tobacco Products Surtax Fund (including any revenues that result from an indirect increase in the tobacco products tax triggered by a cigarette tax increase). The BOE deposits the tobacco products surtax imposed under Section 30131.2 into the CCF Trust Fund.

Proposition 10 Backfill. Health and Safety Code (HSC) Section 130105³ requires the BOE annually to determine the revenue reductions to any Proposition 99 state health-related education and research programs and the Breast Cancer Fund that result directly from Proposition 10's additional taxes. These reductions may result from reduced consumption or increased black market activity due to the increased tax. HSC Section 130105 also requires funds to be transferred from the CCF Trust Fund to affected programs to offset these revenue reductions.

Cigarette and Tobacco Products Licensing Act⁴ (Licensing Act). The Licensing Act requires the BOE to administer a statewide program to license cigarette and tobacco products manufacturers, importers, distributors, wholesalers, and retailers. Business and Professions Code (BPC) Section 22970.1 includes legislative findings and declarations that state "tax revenues have declined by hundreds of millions of dollars per year due, in part, to unlawful distributions and untaxed sales of cigarettes and tobacco products conducted by organized crime syndicates, street gangs, and international terrorist groups." Section 22970.1 further provides that "the licensing of manufacturers, importers, wholesalers, distributors, and retailers will help stem the tide of untaxed distributions and illegal sales of cigarette and tobacco products."

Proposed Law: This complementary measure to SB 591 (Pan) requires the BOE to determine, within one year of passage and annually thereafter, the effect that the additional cigarette tax imposed pursuant to SB 591 and the resulting indirect tobacco products tax increase on cigarette and tobacco products consumption in this state. If the BOE determines the additional cigarette and indirect tobacco products tax directly caused a consumption decrease, the bill requires the BOE to determine the fiscal effect of the consumption decrease on the CCF Trust Fund (Proposition 10), the Cigarette and Tobacco Products Surtax Fund (Proposition 99), the Breast Cancer Fund, and the General Fund, as described.

The bill requires the BOE to transfer funds from the California Tobacco Tax Act of 2015 Fund (Tobacco Tax Fund) to the CCF Trust Fund, the Hospital Services Account, the Physician Services Account, the Cigarette and Tobacco Products Surtax Fund, the Breast Cancer Fund, and the General Fund, to offset the revenue decrease that directly results from the additional cigarette tax and indirect tobacco products tax.

Fiscal Provisions. Except for payments of refunds, SB 591 requires the BOE to deposit all revenues in the newly created Tobacco Tax Fund. This bill establishes the Tobacco Tax Fund as a trust fund established solely to carry out the purposes set forth in the California Tobacco Tax Act of 2015.

Senate Bill 591 transfers Tobacco Tax Fund amounts in specified percentages to the Tobacco Prevention and Education Account, Tobacco Disease Related Health Account, and the Tobacco Law Enforcement Account. This bill further requires:

- **Tobacco Prevention and Education Account** funds transferred to State Department of Public Health (DPH), State Department of Education, and the University of California.
- **Tobacco Disease Related Health Care Account** funds transferred to the State Department of Health Care Services to improve quality and access to specified health care programs.
- **Tobacco Law Enforcement Account** funds transferred to the BOE, Department of Justice, and the DPH for the purpose of "supplementing funding for the enforcement of laws that regulate the distribution and sale of cigarettes and other tobacco products, including, but not limited to, laws that prohibit cigarette smuggling, counterfeiting, selling untaxed tobacco, selling tobacco

³ Added by Proposition 10.

⁴ Division 8.6 (commencing with Section 22970) of the Business and Professions Code (BPC).

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

without a proper license and selling tobacco to minors, and enforcing tobacco-related laws, court judgments, and settlements.”

The bill also states that no more than 5% of the proposed tax may be used to fund any department’s administrative costs.

Operative Date. The bill becomes effective immediately as an urgency statute; however, the act becomes operative only if Senate Bill 591 is also enacted and takes effect on or before January 1, 2016.

Commentary:

1. **Cost reimbursement cap is problematic.** This bill limits funding for any department’s administrative costs to 2% of the Tobacco Tax Fund revenues. The BOE staff recommends an amendment to specify ongoing administrative cost reimbursement to the BOE for its administration, collection, and enforcement of the additional cigarette tax imposed pursuant to the California Tobacco Tax Act of 2015 (SB 591). Although the 2% cap appears to provide adequate funding currently, it is unknown if the cost cap would allow for full reimbursement to the BOE in future years since cigarette tax is a declining revenue source. Tax-paid cigarette distributions are expected to decrease by about 3% per year, as discussed in the Revenue Estimate.

Furthermore, it is unclear whether the 2% cost cap applies to the BOE’s total costs to administer the additional tax and additional enforcement moneys allocated to the BOE from the Tobacco Law Enforcement Account, or only the costs to administer the additional tax.

2. **The June 3, 2015 amendments** add an urgency clause thereby making the bill effective immediately upon enactment. The **June 1, 2015 amendments** (1) add a co-author, (2) specify the allocation percentages from the Tobacco Prevention and Education Account, (3) subject funds in the Tobacco Prevention and Education Account, Tobacco Disease Related Health Account, and the Tobacco Law Enforcement Account to review and appropriation by the Legislature, and (4) increase the administrative cost cap from 2% to 5%.
3. **Proposition 99 backfill.** This measure requires the BOE to determine the effect of the additional cigarette tax imposed pursuant to SB 591 and indirect tobacco products tax on cigarette and tobacco products consumption. To the extent that a consumption decrease directly results from the additional cigarette tax and indirect tobacco products tax increase, the bill requires the BOE to determine the fiscal effect of the consumption decrease on the existing cigarette tax funds: Cigarette and Tobacco Products Surtax Fund, the Breast Cancer Fund, the CCF Trust Fund, and General Fund. The bill directs an amount transferred from the Tobacco Tax Fund to each of the existing cigarette and tobacco products tax funds to offset the revenue decrease resulting from this measure’s additional cigarette and indirect tobacco products tax increase.

In addition to the backfill, the bill indirectly increases the tobacco products tax. Existing law requires the BOE to deposit those new revenues into the Proposition 99-enacted Cigarette and Tobacco Products Surtax Fund. The BOE estimates a backfill to the Cigarette and Tobacco Products Surtax Fund in the amount of \$135.9 million in FY 2016-17. In addition, BOE staff estimates \$65.9 million in new revenues deposited into the Cigarette and Tobacco Products Surtax Fund.

4. **Enhanced enforcement funding.** The bill requires an unspecified percentage of Tobacco Tax Fund revenues to be appropriated, in part, to the Tobacco Law Enforcement Account. The Controller must appropriate moneys from this account to the BOE, DOJ, and CDPH for the purposes of:

Supplementing funding for the enforcement of laws that regulate the distribution and sale of cigarettes and other tobacco products, including, but not limited to, laws that prohibit cigarette smuggling, counterfeiting, selling untaxed tobacco, selling tobacco without a proper license and selling tobacco to minors, and enforcing tobacco-related laws, court judgments, and settlements.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE’s formal position.

The bill does not specify an allocation percentage to each of the agencies. To clarify the allocation process and prevent confusion regarding how to spread the administrative costs of the three agencies that together exceed the account balance, BOE suggests specifying an allocation percentage for each agency. A percentage-based allocation also improves each agency's ability to plan and anticipate staff and available resources.

5. **Related legislation.** SB 591 (Pan) imposes a new \$2 per pack cigarette tax, an equivalent floor stock tax,⁵ and indirectly increases the tobacco products tax. SB 591 becomes operative only if this bill is enacted and takes effect on or before January 1, 2016.

Administrative Costs: BOE absorbable administrative costs related to this bill include staff time to make the backfill calculation and prepare transfers to the specified cigarette and tobacco tax funds.

Revenue Impact:

Background, Methodology, and Assumptions. BOE staff believes that cigarette and tobacco consumption are likely to decline as a result of the higher tax rate. For fiscal year 2016-17 (the first complete year in which the SB 591 excise tax rate is in effect), the California Tobacco Tax Act of 2015 Fund created by SB 591 would receive \$1,290.4 million from cigarette sales at the new tax rate. For background and details of how this amount was calculated, see the BOE Analysis of SB 591.

Revenue Summary. Since this bill will take effect January 1, 2016, the revenue impact in FY 2015-16 will be about half of the revenue impact under a complete fiscal year. Consequently, transfers related to cigarette consumption in FY 2015-16 will be about half of those of FY 2016-17. No transfers related to other tobacco products will be made for FY 2015-16, since the companion bill, SB 591, will not impact the tobacco products tax rate until FY 2016-17.

FY 2016-17 will be the first complete year of the measure's impact. The revenue impacts of the affected funds are shown in the following table. For FY 2016-17, the transfers to be made from the California Tobacco Tax Act of 2015 Fund to the impacted funds will be \$135.9 million.

Revenue Impacts Summary (If SB 591 Becomes Law)		
	Fiscal Year	
	2015-16	2016-17
	(Millions of Dollars)	
Revenues, California Tobacco Tax Act of 2015 Fund (SB 591)	\$665.2	\$1,290.4
Impacts on Existing Funds, Cigarettes:	-\$67.0	-\$130.0
General Fund	-7.7	-14.9
Breast Cancer	-1.5	-3.0
Proposition 99	-19.3	-37.4
Proposition 10	-38.5	-74.7
Associated Revenue Impacts on Other Tobacco Tax Revenues	0.0	97.4
Proposition 99	0.0	103.2
Proposition 10	0.0	-5.9
Total Impacts, Cigarettes and Tobacco Products, All Funds Under Current Law	-\$67.0	-\$32.7
General Fund	-7.7	-14.9
Breast Cancer	-1.5	-3.0
Proposition 99	-19.3	65.9
Proposition 10	-38.5	-80.6
Loss to Tobacco Tax Act of 2015 Fund (Cigarettes and Tobacco Products)	-\$67.0	-\$135.9

⁵ A floor stock tax is a one-time tax on all tax-paid (stamped) cigarettes and unaffixed tax stamps in the possession of distributors, wholesalers and/or retailers on the effective date of a cigarette and tobacco products tax increase. The floor stock tax rate is the difference between the old tax rate and the new tax rate.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Cigarette and related taxable sales revenues are expected to decline in FY 2017-18 and in future years. Tax-paid cigarette distributions are expected to decrease by about 3% per year, consistent with historical trends. Without any other factors affecting revenue, related revenue also would weaken by about 3% per year. As a result, transfers would also decrease commensurately.

With the exception of forecasting greater declines in tax-paid cigarette and tobacco distributions, this revenue estimate does not account for any further changes in economic activity that may or may not result from enactment of the proposed law.